FINTECH AND DIGITAL FINANCE IN CHINA: DEVELOPMENTS AND IMPLICATION

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Executive Summary

1. Digital finance has expanded rapidly in China, driven by technological advances and innovation in online payments and a huge demand to provide funding to the underserved segments of the population, particularly the lower income individuals and small and medium-sized firms.

2. Recognising the importance of digital finance to increasing financial inclusion, in July 2015, the authorities published the *Guiding Opinion on Promoting the Healthy Development of Internet Finance*, proposing a series of policy measures to encourage innovation and support the stable development of digital financing.

3. While a tolerant regulatory environment had facilitated widespread digital financial innovation, it had also created serious financial risks. For instance, the peer-to-peer (P2P) lending platforms were not regulated for almost nine years after the first P2P firm (PPDai) was set up in 2007, with more than 6,000 platforms at its peak.

4. It was only in mid-March 2016 that the authorities announced rules to regulate the P2P platform businesses, most of which had proven to be commercially unsustainable, some having fraudulent practices like the Ponzi schemes, which resulted in significant financial losses for investors. Regulatory scrutiny was further intensified to monitor every sector of FinTech, from payments to lending.

5. Despite the financial risks, initial research suggests that FinTech development has a positive impact on entrepreneurship, jobs and income, especially for those in the rural areas and inland regions. FinTech businesses, especially mobile payment service providers, are said to help further integrate previously segmented regional markets, such as through e-commerce platforms, and reduce market volatility.

6. More importantly, digital finance improves financial inclusion in China. It could drive financial liberalisation and alleviate financial repression particularly for households with interest earnings that are far less than they would have been in a more liberalised financial environment.

7. Digital finance could also act as a buffer for the negative fallout from economic shocks. During the COVID-19 pandemic, offline economic activities (restaurants, shopping at malls and tourism) sharply declined while online activities flourished. China's e-commerce sales were estimated to reach US$1.7 trillion in 2020, equivalent to 30% of all retail sales in the country.

8. During the pandemic, many banks were closed due to the lockdown but the new internet banks continued to operate. MyBank, for instance, collaborated with more than 100 traditional banks and granted more than 10 million loans.

9. Digital finance could potentially contribute to macroeconomic and financial stability in China. Unlike collateralised loans provided by commercial banks, unsecured loans by FinTech firms could mitigate the link between credit and asset prices, thus removing the "financial accelerator" behind most financial crises which creates a vicious cycle among asset price, credit and real economic activities.

10. Improving the regulatory system to strike a balance between innovation and stability is essential. As digital finance is likely to continue to expand with great speed, regulators would need to stay ahead of the curve and manage the risks that come with financial innovation. In some cities like Beijing and Shanghai, sandbox regimes were implemented to balance FinTech innovation and financial stability.